

DEPARTMENT OF STATE A/CDC/MR

10 AUG 1981

REVIEWED BY

RDS for XDS
TS AUTH.
ENDORSE EXISTING
DECLASSIFIED
RELEASE DOWNT
PA or FOR EXEMPTIONS

FE - John M. Allison

WE - Robert W. Barnett

Subject: A New United States Program for Formosa

2

TOP SECRET

Please return to
Philip H. Watts
Room 5147, N.S.

FED

Discussed at S/P

meeting with

Barnett

2/14/82

This is my reply to your invitation to put in writing the proposal I developed last Friday for converting the present static and defensive relationship of the United States and Formosa into one which could enable that Island to become a dynamic rallying point for all anti-and non-Communist Chinese.

We can do this, I believe, without increases in United States appropriations or diminution of Formosa's military capabilities, but a prerequisite would be for the United States to announce publicly that regardless of the outcome of current Korean armistice negotiations we intend that the present mission of the Seventh Fleet in the Formosa Straits will be continued; this is necessary to quiet fears of Chinese who know very well that Formosa alone cannot defend itself regardless of the size of its own military forces.

If we consider such an announcement to be in our self-interest, my proposal would then become practical. In short, it would be to obtain Chinese consent to have the costs of the military establishment on Formosa transferred from New Taiwan dollar account to United States dollar

TOP SECRET

account.

TOP SECRET

-3-

a military overload which is causing depletion of productive capabilities and gradual paralysis of latent administrative talent. More than that, they would convert a drain, into an important source of foreign exchange earnings for Formosa's potentially extremely productive agriculture and industry.

They would supply our MAAG with leverage to cope with serious impediments which now stand in the way of effective execution of its program of reorganizing, equipping and training the Chinese military establishment. These are its self-destructive personnel and supply policies at the bottom and an obsolete and pernicious command structure at the top.

They would create a situation in which American aid, advice, pressure and intervention would be confined to the military sector of Formosan society, thus enabling the responsible civilian Chinese leadership which exists on Formosa to operate government by Chinese methods of administration. Freed of fears of invasion and inflation, I have no doubt that, without American interference and coercion, these Chinese leaders, have the ability to achieve successes in the political, administrative, economic, and social spheres which would soon command the respect of overseas Chinese everywhere and the envy of Mainland Chinese ground under by Communist police discipline.

TOP SECRET Formosa can

TOP SECRET

-4-

Formosa can play a dynamic part in Far Eastern Free World strategy only if it becomes a demonstrable symbol of durable, realistic, forward-looking, and successful Chinese nationalism. Under our present arrangements in and concerning Formosa, it is not that symbol. All illusions and false hopes aside, we are supporting by our present aid programs, a Formosa which is a feeble ally in United Nations councils, has some harbors, some airfields, some mismanaged military manpower of doubtful combat quality, and little else. Meanwhile, our best Allies doubtfully acquiesce in our venture and remain skeptical that we understand the underlying political, economic, and psychological forces which are generating crisis in the Far East - including Formosa.

The root reason why Formosa is not what it could be is easy to identify. Six to seven hundred thousand men - or some 7 - 9 percent of its population - are wholly and directly employed by the military establishment. Compare this with 3/4 of 1 percent in the Red Armies of "militarized" Communist China. Both Formosa and Mainland China are dominantly agricultural societies. No such society can bear the burden of costly and non-productive manpower that Formosa tries to bear without committing suicide. Our so-called "economic aid" program has been a clumsily

executed

TOP SECRET

TOP SECRET

-5-

executed effort to prevent that from happening.

I am confident that there exists on Formosa the potentiality to achieve the political, economic, and psychological results I foresee. However, I would not advance my proposal if I felt that only Formosa was affected; it involves us in real and implied military commitments which reduce our field of strategic maneuver. Risks are worth taking, however, for major objectives and I believe that our main objective in the Far East should be to foster, encourage, induce, and/or force the resurgence, within Communist China itself, of a Chinese nationalism which will rebel against Russian leadership and control. In Korea we serve this end by killing Chinese Red Army troops, but we should not rely exclusively on military means. Formosa can help to undermine Communist Mainland authority by being, for Chinese, that pole of political attraction which could result from existence of a Chinese government on Formosa serving well the welfare needs of its people, preserving their basic human freedoms, and coming to be accepted, amongst freedom-loving people of the non-Communist world, as an authentic expression of independent Chinese nationalism.

The cost of assuming full responsibility for paying in dollars the costs of the Chinese military establishment would be no more than we envisage paying annually during

TOP SECRET 1952

TOP SECRET

-6-

1952 and 1953 for our ECA programs on Formosa. We are asking Congress for \$115 million for Fiscal 1953 of which \$35 million will be for civilian-type military supplies (mainly petroleum products) and \$80 million for economic aid. Even the \$80 million, however, is predominantly for military support as can be seen from the fact that from this sum \$69 million will be used for commodities, the counterpart local currency value of which is predominantly intended for direct budgetary assistance, MDAP support, and indirect and invisible requirements owing directly to military impact. Economic aid for current consumption and for generating counterpart merely to be used in balancing fiscal deficits caused by military spending is a static, holding operation for which, with available funds, no good end is in sight. Our ECA Mission would like to engage in projects contributing to Formosa's self-support more rapidly, but it simply cannot use its money that way without adding dangerously to inflation which, of all of its problems, is the most immediate and nightmarish.

The difficulty of our aid programs for Formosa, however, is not lack of funds but the method of their use. The total Chinese budget (National, Provincial, and Municipal) amounts to NT \$2.2 billion in calendar 1952.

Military

TOP SECRET

03115587000

TOP SECRET

-7-

Military expenditures are budgeted at NT \$1.2 billion. The \$80-90 million that is available to ECA during calendar 1952 placed in the hands of MAAG would yield no less than NT \$1.2 billion at the commercial rate of exchange (NT \$15: US \$1) or NT \$2.4 billion at the black market or free rate (NT \$30: US \$1). This would be equivalent to removing all military expenditures from the Formosan budget, thus creating a situation where, even with some downward revision in revenues, government income could begin to finance a range of the productive and development projects which the wasteful, uncertain and (fantastically) roundabout technique of commodity sum counterpart assistance has woefully failed to do.

The justification for adoption of my proposal should be looked for not only in its military and economic, but also in its political results. There are three power grouping on Formosa: The Generalissimo and his Entourage, the Mainland Modernists, and the Formosans. Seventy percent of the population is Formosan. They are disgruntled, nostalgic about Japanese colonial rule, but, for the time being, they are deaf to Communist propaganda and they are politically passive. The other two groups are not clearly separate. Many Modernists owe their offices to the Generalissimo; Sun Li-jen, Chinese Ground Forces Commander in Chief, is in a chronic state of revolt,

philosophically,
TOP SECRET

TOP SECRET

-8-

philosophically, against the Generalissimo's entourage to which he belongs. But the groupings are real and significant.

The Entourage is blindly loyal to Chiang Kai-shek and is driven by the one idea that it is his mission to lead the Kuomintang back to the China Mainland. It admits no error in its conduct of government when on the Mainland. It clings to cliches of outworn revolutionary doctrine which served barely well enough back in 1911 and 1927. It considers sacrosanct the ramshackle military-police organization that was almost all that was left of government during the expiring days of Kuomintang rule on the Mainland.

Of this military-police organization, General Chase said to me last summer (Memorandum of Conversation, August 30, 1951) that the most serious problems he encountered in accomplishing his mission on Formosa were created by the Political Department of the Ministry of National Defense, headed by the Generalissimo's son Chiang Ching-kuo, whose informers, counterintelligence agents and "political commissars" engendered paralyzing fears, suspicions, timidity, and buckpassing throughout the whole structure of command within the National Military Establishment, and by the Combined Service Forces (a command which is

TOP SECRET

SECRET

TOP SECRET

-9-

which is co-equal with Army, Navy, and Air Force) whose blundering operations in the supply and procurement field have failed to meet military requirements, but have wreaked havoc with Formosa's banking institutions, agriculture, and industry, and, of course, the national budget. The damage done by these two agencies of the Generalissimo's power and influence is what the Modernists try to make good.

I talked with some of these Modernists last September. From Taipei and Keelung in the north to Kaohsiung in the south, I talked with cabinet ministers, bankers, engineers, harbor masters, scientists, educators, and merchants. I had gone to Formosa skeptical about their competence and state of mind. I had met men like this in Shanghai before the war, in Yunnan and Szechuan during the war. After seventeen days of intensive study, I came to the conclusion that no part of China previously has been so well furnished with the human resources to operate a modern and progressive society. These Modernists are acutely aware of the Kuomintang's Mainland failures and will discuss them candidly with you - in private. They are only now beginning to appreciate fully Japan's accomplishment in making Formosa a model of colonial rule. They see a Formosan farm population which is more literate, with technology

TOP SECRET

CONFIDENTIAL

TOP SECRET

-10-

technology more advanced, than any Asian society outside Japan. They see an island with ample communications, a rail system better than that of any Mainland Chinese province, excellent roads and highways, and adequate hydroelectric power facilities for operation of the modest but potentially important pattern of industry which the Japanese left behind. They see well laid out cities and towns, with telephones, electric lights, running water, sewerage disposal systems. They see excellent ports, both in the north and the south. Despite all of these assets and promising prospects, however, they suffer a great sense of hopelessness - perhaps, humiliation. They know that they must succeed on Formosa, and if possible make it a model province, if the National Government of China on Formosa is ever to make an effective bid for the support of the Chinese people on the Mainland. Yet, they know that without a stable currency, social security, and real incentives for production and development, they - the Modernists - are unable to acquire that political strength necessary for forcing the changes they desire. They regard the Generalissimo's military-police establishment as the crucial obstacle to success; they will not even discuss its military potentialities, beyond saying that that is something that the Generalissimo and the United States

TOP SECRET

0315087000

TOP SECRET

-11-

the United States know about.

The Chinese Modernists cannot solve problem of Formosa's military overload. They are getting very tired of trying. The proposal I have discussed here is intended to cope with a problem we can solve for them, with no greater outlay of funds and perhaps with an increase in combat capability of the Chinese on Formosa. If we do, the Modernists can begin to exercise their constructive capabilities for achieving those results on Formosa, which can have important effect upon the China Mainland, and for our standing and that of the Chinese throughout the Free World.

This is getting to be an over-long memorandum. I must not close, however, without a word of caution. My proposal should not be adopted unless we are prepared to speak plainly to the Generalissimo. He stands to gain, but he may not know it or understand how. If we talk too deferentially or timidly, he may accept with intent to subvert our purposes. Therefore, we should talk very bluntly and we should be prepared to administer our plan fastidiously; Defense should feel as accountable for dollars spent in Formosa as in the United States, if not more so. Further, my proposals should not be adopted unless we are prepared to diminish substantially whatever freedom for maneuver we now may have, in deciding what

TOP SECRET our relation

TOP SECRET

-12-

our relation to Formosa is to be over the coming years. Finally, my financial computations are impressionistic; they are based on official figures - ECA program justifications, Chinese Economic Stabilization Board minutes and documents, etc. - but they are not hedged about with qualifications and explanations. I do not, however, regard them as overly optimistic because I have left out of account entirely an economic process which I consider certain to begin if my proposal is adopted: a very large flow of Chinese investment capital for industrial development coming to Formosa primarily from Hongkong, but also from other overseas Chinese who are eager to put idle money to productive use in hard currency areas of the world.

I have not tried to write an NSC policy paper for you. If I have planted a germ of an idea, this letter has served its purpose. No one could know better than I how much work has to go into Formosa policies and programs before they are finally adopted. For a good many months I have had a hand in that work for Walt, Dean, and now for you.

All best wishes for the months ahead.

TOP SECRET